Direct Dial: 020-7901 7437

28 October 2002

Shippers, Transco and Other Interested Parties

Our Ref: Net/Cod/Mod/0555

Dear Colleague,

Modification Proposal 0555 '*Interruptible Transportation Charges*'

Ofgem has considered the issues raised in Modification proposal 0555 *'Interruptible Transportation Charges'*. Ofgem has decided to accept the proposal because we believe that it will better facilitate the relevant objectives of Transco's network code.

In this letter, we explain the background to the modification proposal and give the reasons for making our decision.

Background to the proposal

The existing exit capacity, interruption and LNG arrangements

Transco currently manages network constraints under the existing exit capacity, interruption and Liquefied Natural Gas (LNG) arrangements mainly by interrupting gas supply to customers with interruptible transportation agreements. Transco may call interruption in the event of network capacity constraints, high system demand, in an emergency or for testing purposes.

Interruptible transportation arrangements can be included in contracts between shippers and their customers. Typically, such contracts provide both for some level of shipper interruption ('commercial interruption') as well as Transco interruption. At present, any supply point that has daily metering and annual consumption in excess of 5.86 GWh can apply for interruptible status.

In terms of Transco interruptions, Transco distinguishes between Standard Interruptible (SNI) and Transco Nominated Interruptible (TNI) supply points. An SNI agreement allows Transco to interrupt the site for up to 45 days each year, while a customer with a TNI agreement may face greater than 45 days of interruption. In addition, Transco may unilaterally designate an interruptible point (either a SNI or a TNI) as a Network Sensitive Load (NSL). Such loads, by virtue of their location, are more likely to be interrupted.

In return for having interruptible status, a customer receives relief from various charges. An SNI site pays no National Transmission System (NTS) exit capacity or Local Distribution Zone (LDZ) capacity charges. In addition to this, a TNI site receives a reduction in NTS commodity charges. No additional compensation is provided to an NSL.

SO incentives – final proposals and Transco's Gas Transporter licence

On 27 September 2002, Ofgem directed that a number of modifications to Transco's GT licence be made with effect from 1 April 2002. These licence modifications introduced into Transco's GT licence its price control and system operator (SO) incentives for April 2002-7.

The licence modifications provided for two stages of reform for the exit capacity regime, including transitional SO exit capacity incentive arrangements as well as proposals for the longer-term reform of the exit capacity regime to be implemented from 1 April 2004.

Under the transitional arrangements, interruptible supply points would continue to avoid NTS exit capacity charges and, in the case of LDZ interruptible supply points, LDZ capacity charges. Transco would also retain its existing rights to interrupt SNI supply points for up to 45 days a year and TNI supply points for more than 45 days a year. Under its incentive arrangements, Transco would however make additional fixed payments per day of interruption with respect to interruptible sites that are interrupted on more than 15 days in any year. Under these arrangements, Transco will receive a target allowance for making payments in respect of interruptions of sites on more than 15 days in each year. To the extent that Transco manages to beat this target it will retain a share of any difference. Conversely, if the costs of interruption in excess of 15 days exceed the target, Transco pays a proportion of the difference.

In addition to Transco's incentive with respect to interruptions beyond 15 days, Transco faces a similar incentive to keep the costs of interruptions up to 15 days below a target allowance.

In respect of the long-term exit capacity arrangements, Transco has a licence obligation to use all reasonable endeavours to ensure universal firm registration of NTS exit capacity with effect from 1 April 2004.

Pricing Consultation 74 – Interruptible transportation charges

On 22 July 2002, Ofgem decided not to veto pricing consultation (PC) 74 which proposed a change to Transco's pricing methodology with respect to charging for interruptible customers. The proposal took effect from 1 October 2002.

This proposal introduced, in addition to the present interruptible exemptions from the relevant NTS exit capacity and LDZ capacity charges, a transportation credit payable when individual supply points are interrupted for more than 15 days in a year. This transportation credit, which is payable for each additional day of interruption over 15 days, will be equivalent to one fifteenth of the annual NTS exit capacity and LDZ capacity charges avoided as a result of the interrupted supply point having interruptible rather than firm transportation rights. Under this new pricing methodology, Transco's existing rights to interrupt a supply point for up to 45 days a year, in the case of SNI supply points, or more, in the case of TNI supply points, remain unchanged.

As part of the proposal, the present commodity discount applicable in respect of TNI supply points was discontinued.

The proposal

Modification proposal 0555 proposes to reduce the level of transportation charges in respect of supply points that Transco interrupts on more than 15 days in a year (measured from April to March). The modification proposes that for each day of nominated interruption over 15 days, a transportation charge credit would be available, equivalent to 1/15 of the annual NTS exit capacity charge and LDZ capacity charges avoided as a result of the interrupted supply point having interruptible rather than firm transportation rights. Transco's existing right to interrupt a supply point for up to 45 days a year, or more for TNI supply points, would not be changed.

The proposal sets out details on the manner in which the credit would be calculated in respect of supply points, as well as the manner in which the count of interruption occurrence will be undertaken. The proposal describes the circumstances in which an interruption would qualify (for the purposes of the calculation of the transportation credit), as well as details concerning invoicing and the provision of information regarding interruption.

The proposal specifies the network code changes necessary to implement the removal of the existing TNI commodity discount following the implementation of PC74.

Respondents' views

The majority of respondents supported the proposals. In some instances, this support was qualified. Several respondents, including some who were not supportive of PC74, recognised that this modification proposal was necessary to allow the implementation of PC74. One respondent commented that it seemed fair for those sites that provide a greater service to Transco to receive greater benefits than those that are rarely interrupted.

A small number of respondents did not support the proposal. However, they recognised the necessity of the proposal to implement the intent of PC74. These respondents believed that the removal of the TNI discount will result in TNI sites paying higher transportation charges while facing the same or increased risk of interruption and the same costs of maintaining back-up fuel capability and stock.

A number of respondents commented on Transco's proposals to publish information regarding interruption and the count of days on which sites had been interrupted. One respondent commented that the threshold against which Transco would publish the number of days of interruption should be set at 10 days rather than 12. Another requested Transco to provide as soon as possible and at a site-specific level the information regarding how often registered sites in a shipper's portfolio have been interrupted in the period April to December 2002. One respondent suggested that Transco should publish for 2001-02 and 2002-03, interruption frequencies by site size band and also the number of NTS and LDZ supply points interrupted as a means to monitor Transco's operational decisions. Another stated that it was unclear as to how an incoming shipper would be advised of a site's count of interrupted days.

A number of respondents made specific comments about the business rules. One respondent believed that there were a number of inconsistencies within the business rules and sought clarification about the use of an averaging approach for the setting of the relevant compensatory amounts. Another respondent sought clarity that where an error has occurred in the calculation of capacity a reconciliation payment could be made later. A further respondent argued that a partially interruptible site should receive payment for interruption based on the total site interruptible exit capacity rather than being limited to the proportion of capacity that was actually interrupted. The respondent continued that the site day count makes no distinction between full and part day interruption and that Transco should conduct the calculation of charge quantity consistently.

Some respondents commented that Transco should focus on the development of the long-term arrangements. One respondent added that it hoped Transco could ensure that the final structure of the exit regime was in place by October 2003.

Transco's view

Transco supported modification proposal 0555 as it is intended to enable the implementation of PC74. Transco stated that the proposal reflects the transitional interruption arrangements outlined by Ofgem in its proposed modifications to Transco's GT licence.

In response to the issues raised in the consultation, Transco explained that users would retain the ability to challenge the basis of the invoice should they believe that erroneous data has been used. As regards partial interruptible sites, Transco maintained that payments should not be made for partial loads that have not been interrupted as the transitional exit arrangements are meant to encourage Transco to minimise the incidence and extent of interruptions.

Transco stated that the threshold of 12 day of interruptions for notifying to certain sites that they are approaching the 15-day measure could be adjusted if experience led it to believe that the proposed level is inappropriate.

Following concerns about the publication of site-specific information, Transco has amended the original proposal to reflect its agreement with the industry that only aggregate information should be published. Transco also stated that it would amend its monthly report issued to Users to include the count for each interruptible site in the User's portfolio.

Ofgem's view

As was outlined in our decision on PC 74, Ofgem believes that the transportation credits payable under this proposal better reflect the value to Transco of the costs saved and the services provided by interruptible sites that are interrupted in excess of 15 days in a year. In this respect, Ofgem considers that the proposal represents a move towards more cost reflective charging for interruption.

Further, Ofgem considers that the proposal goes some way to addressing the potential discriminatory treatment between different types of interruptible customers that exists under the current exit and interruptions regime to the extent that similar discounts have been granted to sites that provide different levels of interruptible service. In this respect, Ofgem believes that the proposal, by enabling the implementation of the pricing methodology set out in PC74 should better facilitate the securing of effective competition between relevant shippers and relevant suppliers.

Ofgem notes the concerns that have been expressed by respondents regarding the removal of TNI commodity discount. However, as outlined in our decision letter for PC74, Ofgem believes that in circumstances where Transco makes additional payments to sites that are interrupted for more than 15 days a year, there is at present no need for additional compensation to be paid in the form of the commodity discount to TNI customers.

Nevertheless, Ofgem understands the concerns that have been raised and we would urge those who have these concerns to participate fully in the development of long term exit capacity arrangements that ensure that interruptible contracts reflect the true value to Transco of the costs that it saves through these contracts relative to the costs of pipeline investment or the use of LNG.

Ofgem's decision

Accordingly, Ofgem has decided to consent to this modification, as we believe that it better facilitates the achievement of the relevant objectives as outlined under standard condition 9 of Transco's Gas Transporter's licence.

If you have any queries in relation to the issues raised in this letter, please feel free to contact me on the above number.

Yours sincerely,

Mark Feather
Head of New Gas Trading Arrangements